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FEDERAL COMMUNICATIONS COMMISSION OFFICE OF THE SECRETARY

November 13, 1998

Ms. Magalie Roman Salas, Secretary **Federal Communications Commission** 445 12th Street, SW TWA 325 Washington, DC 20554

RE: Ex Parte Conversation in CC Docket No. 96-45 and DA 98-1587

Dear Ms. Salas:

On Friday November 13, 1998, I sent an informational package to Commissioner Susan Ness on behalf of OPASTCO. It discussed rural universal service issues.

I submit two copies of this letter.

Enclosure

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE " "TANK"



November 12, 1998

The Honorable Susan Ness Commissioner Federal Communications Commission 1919 M Street, N.W. Washington, DC 20554

Dear Commissioner Ness:

I enjoyed your remarks at the NARUC Convention concerning universal service. I have been doing some work with OPASTCO on small company universal service issues, and I know that your message that the work of the Joint Board is not now directed to small companies was heard and received loud and clear and was taken in the spirit of reassurance that you clearly conveyed in your remarks.

At the same time, there is among small companies a concern that the principles, paradigms and parameters adopted with respect to large ILECs will likely eventually come to apply to small companies unless they can begin showing now how small companies' circumstances vary materially from large companies' circumstances. Beyond what you have already taken care to say -- very clearly -- about the current work of the Joint Board not applying to small companies, an additionally welcome message would be that you have an open mind with respect to what principles *should* apply to small companies, when it eventually comes time to consider what regime should apply to them. It may very well be that this message was implicit in your already clearly delivered message; making it explicit would aid the small companies' understanding of the process and work substantially to calm the concerns that they have been expressing.

I am enclosing a copy of the slides that I used in my presentation to the Staff Subcommittee on Saturday during the Convention. The purpose of the presentation was to acquaint members of the Subcommittee about a paper that I wrote with OPASTCO on universal service issues, and to give them a perspective on why small companies are

focusing on this issue now, even though the subject de jour is large ILEC issues. The title of my presentation, which lacks any connection to the safari animals motif of the convention, is at least connected to the vehicle that one uses on such expeditions, the Jeep: "Objects In Mirror Are Closer Than They Appear."

It was good to see you in Orlando; best wishes with the home stretch on the Joint Board process.

Very truly yours,

Kathleen M.H. Wallman

RURAL AMERICA: CONNECTIONS TO THE FUTURE



The Telecom Act of 1996:

Congress' New Vision for Universal Service for Rural America

POLICY DECISIONS NEEDED TODAY ARE DIFFERENT

- More about managing transitions than directing outcomes
- Examples of outcome regulation --
 - How much should cable rates be brought down?
 - What should the X-factor be set at?

POLICY DECISIONS NEEDED TODAY ARE DIFFERENT

- Example of transition management decisions
 - What rules should affect voice over IP traffic?
 - Managing the transition from circuit to packet
 - What rules should govern universal service during the transition to an extensively competitive market?

TRANSITION MANAGEMENT IS TRICKY



- Not always clear where the transition is going.
- Cycle of technology change has accelerated, and rate of technology adoption has increased, so transitions unfold within transitions.
- Intermediate choices can make huge differences down the road.

SMALL RURAL ILECS IN TRANSITION

- Well understood that large ILEC issues need to be worked out first.
- Appreciation that many of the principles adopted for large LECs will be applied to small ILECs, absent compelling distinctions.
- Apprehension about the moment to make that case.

The Telecommunications Act of 1996: Congress' New Vision for Universal Service for Rural America

- Reviews the major mandates of the Act.
- Respectful evaluation of how the FCC has implemented those mandates in conjunction with the Joint Board.
- An appeal to policymakers to continue to be mindful of small company distinctions as large ILEC issues are worked out.

WELCOME OPEN MINDEDNESS AND MINDFULNESS ALREADY

- 25/75 split not required by the Act, and a danger to fulfilling universal service mandate.
- Cream skimming in rural areas requires special attention.
- Effect of proxy models and FLEC on small companies
- Interplay with Section 706

WELCOME OPPORTUNITIES TO MOVE FORWARD

- Rural Task Force
- Early collaboration on inputs
- Early understanding of likely impacts of model plus inputs on small rural ILECs
- Flexibility for exception cases.

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RURAL AMERICA:

FEDERAL COMMUNICATIONS COMMISSION OFFICE OF THE SECRETA CONNECTIONS TO TH

The Telecommunications Act of 1996: Congress' New Vision for Universal Service for Rural America

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Kathleen Wallman

President, Wallman Strategic Consulting, LLC

Former Chief of Staff of the National Economic Council and Deputy Assistant to the President for Economic Policy; Former Deputy Counsel to the President; Former Chief, Common Carrier Bureau, Federal Communications Commission

OVERVIEW OF WHAT'S INSIDE

- A strong, rural telecommunications infrastructure, as envisioned by Congress, benefits all Americans, wherever they live and work (white paper pg. 8).
- Regulations must be re-examined to ensure that FCC policy reflects Congress' vision for rural telecommunications and development (white paper pp. 18, 32, 37, 40).
- Federal responsibility for universal service support mechanisms must be sufficient, specific and predictable, as required by the Act (white paper pp. 4, 20, 22, 34).
- The use of proxy models and forward-looking economic costs will create communications winners and losers in rural America (white paper pp. 33, 38,41).
- Some FCC decisions threaten investment in the rural telecommunications network (white paper pp. 11, 18, 23, 25).
- For small telephone companies, universal service is much more difficult to maintain when new entrants cream skim low-cost customers (white paper pp. 32, 33).



The Act firmly established a mandate of universal service in rural areas that is equivalent to what is available in urban areas. The FCC has a significant amount of work still ahead of it to complete the universal service responsibilities delegated to it by Congress in the Telecommunications Act of 1996, with respect to small companies that serve rural customers. It has wisely delayed some of the major decisions entrusted to it in this area, and has maintained much of the status quo for small companies that serve rural customers and has adopted a transition plan, affording itself the time needed to resolve these important issues.

At the same time, it is important that these issues not be left on hold too long, because investment incentives and decisions hang in the balance. And the policy decisions need to be made, as the FCC's actions to date have acknowledged but not entirely embraced, with a particular awareness about how those decisions will affect telephone customers in sparsely populated areas where distance and terrain make providing service more challenging and more costly.

Some of the FCC's actions to date require further realignment with the statute's treatment of small companies that serve rural areas:

Federal Universal Service Support Mechanisms Must Be Sufficient, Specific and Predictable:

In May 1997, the FCC decided that the federal jurisdiction would fund only up to 25 percent of the universal service requirement, with the rest to be funded by the states. This split is not required or sanctioned by the statute, which, to the contrary, directs the FCC to ensure that federal universal service support mechanisms are sufficient, specific and predictable. The FCC's expressed willingness to reexamine this decision is a welcome reopening of the issue.

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of work still ahead
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Act of 1996.

2. Some FCC Decisions Threaten Investment in the Rural Telecommunications Network:

The FCC's decisions place great emphasis on the importance of preparing all areas of the country, including rural areas, for competition. So far, however, the FCC's decisions have not taken into account the adverse incentives that its decisions may have on investments to extend network infrastructure to remote areas. This creates the risk that incumbent companies that undertake such construction may be left holding the bag when new entrants arrive and may be left without an adequate way to recover their original investment.

3. For Small Telephone Companies, Universal Service is Much More Difficult to Maintain When New Entrants Cream Skim Low-Cost Customers:

The FCC decided to treat facilities obtained by a new entrant from the incumbent local exchange, provided as unbundled elements, as the new entrant's "own" facilities. This approach falls short of giving the words of the statute their natural meaning – what is obtained by permission, on a



derivative basis – leased, in effect — from another is not normally thought of as being owned by the lessee. This approach will allow a new entrant to build facilities in the most densely populated part of a rural area, and serve the rest of the area via elements leased or resold from the incumbent. This will qualify the new entrant for universal service support, and allow the new entrant to skim the cream to compete in rural areas, making service to the most sparsely populated areas served by small companies more expensive and more tenuous.

There is still time for the FCC to refine its decisions in this area. Specifically:

Federal and State Regulators Should Work Together to Resolve Jurisdictional Responsibility for Funding Universal Service:

The FCC should pursue the reopening of the 25/75 split issue.

2. The Use of Proxy Models and Forward-Looking Economic Costs Will Create Communications Winners and Losers in Rural America:

The FCC should take the time needed, but not wait too long, before resolving whether and how to apply proxy models and forward-looking costs to small, rural companies. Investment decisions hang in the balance. Absent significant improvements in the models that give more confidence that they will reflect reality, the FCC should use embedded costs for small companies that serve rural customers. The risk that inaccuracies will be magnified is too great, creating communications winners and losers in rural America. Also, indications that the transition for rural companies need not be subject to a strict deadline are a welcome sign of flexibility.

3. Develop a Transition Plan That Specifically Addresses the Needs of Small Telephone Companies Serving High-Cost Areas:

The FCC should take care to build a transition that will not leave incumbents without recourse for construction if a customer "ports" the universal service support to a new entrant.

4. Technology Advances are Blurring the Definition of a Telecommunications Carrier and Make Competitive Neutrality More Difficult to Reach:

The FCC should resolve the debate over competitive neutrality and the Internet fairly, but in a way that recognizes that Internet technology is a new paradigm in telecommunications policy.

5. Regulatory Efforts for Competitive Neutrality Must Meet Congress's Vision for Rural America:

The FCC should seek congressional clarification of statutory authority to treat facilities, obtained by a new entrant as unbundled elements, as the new entrant's "own" facilities for purposes of qualifying for universal service support. This may be what Congress intended, but it is not apparent from the natural usage of the term, and it may permit cream skimming that will compromise small companies' abilities to serve high-cost areas.



6. The Definition of Universal Service Should Ensure That Rural Markets Have Access to Advanced Technologies:

On the occasion of its next review of the definition of universal service, the FCC should look for ways, consistent with the Act, to describe capabilities of the network that should receive support, rather than enumerating services. Reliance on Section 706 of the Act, which directs the FCC to see to the deployment of advanced telecommunications services, may be a way to do this.

The promise of the Act and its universal service provisions is making the best network in the world even better and more ubiquitous, which will improve lives in ways that are barely foreseeable. This was what impelled me to remain involved in telecommunications policy after leaving the government in the fall of 1997, and to remain committed to implementation of the '96 Act in a way that would lead to a modern universal service policy of better, faster, more accessible and more ubiquitous networks.

This paper examines the universal service provisions of the Act and analyzes the Federal Communications Commission's implementation of them. I offer my assessment with great respect for the agency's work, even in those areas where I have concluded that the Commission's policy cuts would benefit from reevaluation. While this paper was underway, the FCC indicated that it is prepared to keep an open mind on some of these key issues, particularly as they affect small telephone companies that serve rural customers.

This open-mindedness is extremely important. Implementing a modern universal service policy, while introducing competition, is a huge challenge. It needs to be confronted with an appreciation of the trade-offs that will be required. Universal service is fundamentally about moving telecommunications revenues around the system to cover costs, and that does not occur in a competitive world on its own. It requires careful attention to the special cases that need to be solved—for example, high cost assistance to small telephone companies. There is room to fulfill the Act's mandates and to treat special cases with the care they need and deserve, in order to make sure that the resulting policies of competition and universal service serve telecommunications consumers everywhere in the country.



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